

BLIMPIE OF CALIFORNIA, INC.

**FINANCIAL STATEMENTS
DECEMBER 31, 2004 AND 2003**



Certified Public Accountants and Business Advisors

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Blimpie of California, Inc.

We have audited the accompanying balance sheets of BLIMPIE of CALIFORNIA, INC. (a C corporation) as of December 31, 2004 and 2003, and the related statements of income, stockholder's equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BLIMPIE of CALIFORNIA, INC. as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted the United States of America.

Habif, Arogeti & Wynn, LLP

March 19, 2005

Atlanta, Georgia

Habif, Arogeti & Wynn, LLP

Glenridge Highlands Two ♦ 5565 Glenridge Connector ♦ Suite 200 ♦ Atlanta, Georgia 30342

404.892.9651 ♦ Fax 404.876.3913 ♦ www.hawcpa.com

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BLIMPIE OF CALIFORNIA, INC.

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BLIMPIE OF CALIFORNIA, INC.
BALANCE SHEETS
DECEMBER 31,

ASSETS

	<u>2004</u>	<u>2003</u>
<u>Current assets</u>		
Cash	\$ 19,023	\$ 40,104
Accounts receivable, net of allowance for doubtful accounts of \$30,000 for 2004 and \$30,000 for 2003	<u>197,065</u>	<u>236,496</u>
Total current assets	<u>216,088</u>	<u>276,600</u>
<u>Equipment</u> , at cost, net of accumulated depreciation of \$15,059 for 2004 and \$14,989 for 2003	<u>255</u>	<u>325</u>
<u>Other assets</u>		
Advances to affiliates	210,798	210,798
Advances to officers	378,795	335,988
License agreement, net of accumulated amortization of \$96,666 for 2004 and \$92,916 for 2003	<u>3,334</u>	<u>7,084</u>
Total other assets	<u>592,927</u>	<u>553,870</u>
	<u>\$ 809,270</u>	<u>\$ 830,795</u>

LIABILITIES AND STOCKHOLDER'S EQUITY

<u>Current liabilities</u>		
Lines of credit	\$ 63,005	\$ 67,342
Accounts payable and accrued expenses	119,436	121,701
Due to advertising fund	<u>175,218</u>	<u>340,826</u>
Total current liabilities	<u>357,659</u>	<u>529,869</u>
<u>Deferred income</u> , net of deferred expense of \$21,500	<u>25,845</u>	<u>25,845</u>
<u>Stockholder's equity</u>		
Common stock, no par value: 10,000 shares authorized, 640 shares issued and outstanding	640	640
Paid-in capital	83,627	83,627
Retained earnings	<u>341,499</u>	<u>190,814</u>
Total stockholders' equity	<u>425,766</u>	<u>275,081</u>
	<u>\$ 809,270</u>	<u>\$ 830,795</u>

See auditors' report and accompanying notes

BLIMPIE OF CALIFORNIA, INC.
STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31,

	<u>2004</u>	<u>2003</u>
<u>Revenue</u>		
Continuing franchise fees	\$ 525,962	\$ 499,266
Initial franchise fees	42,000	0
Other	<u>0</u>	<u>58,812</u>
Total income	<u>567,962</u>	<u>558,078</u>
 <u>Expenses</u>		
Continuing licensing fees	139,224	150,632
Initial franchise fees to licensor	21,000	0
General and administrative expense	245,546	199,117
Rent	<u>11,507</u>	<u>12,739</u>
Total expenses	<u>417,277</u>	<u>362,488</u>
Income before taxes	150,685	195,590
Income taxes	<u>0</u>	<u>0</u>
Net income	<u>\$ 150,685</u>	<u>\$ 195,590</u>

See auditors' report and accompanying notes

BLIMPIE OF CALIFORNIA, INC.
 STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
 FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	<u>Common Stock</u>		<u>Paid-in Capital</u>	<u>Equity (Deficit)</u>	<u>Advances to Total</u>
	<u>Shares</u>	<u>Amount</u>			
Balances, January 1, 2003	640	\$ 640	\$ 83,627	\$ (4,776)	\$ 79,491
Net income	<u>-</u>	<u>-</u>	<u>-</u>	<u>195,590</u>	<u>195,590</u>
Balances, December 31, 2003	640	640	83,627	190,814	275,081
Net income	<u>-</u>	<u>-</u>	<u>-</u>	<u>150,685</u>	<u>150,685</u>
Balances, December 31, 2004	<u>640</u>	<u>\$ 640</u>	<u>\$ 83,627</u>	<u>\$ 341,499</u>	<u>\$ 425,766</u>

See auditors' report and accompanying notes

BLIMPIE OF CALIFORNIA, INC.
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31,

Increase (Decrease) In Cash

	<u>2004</u>	<u>2003</u>
<u>Cash flows from operating activities</u>		
Net income	\$ 150,685	\$ 195,590
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for bad debts	30,000	30,000
Depreciation and amortization	5,094	5,467
Changes in operating assets and liabilities		
Increase in accounts receivable	(69,431)	(160,105)
Decrease in accounts payable and accrued expenses	(2,265)	(36,291)
Increase(Decrease) in due to advertising fund	(165,608)	32,828
Decrease in deferred income	<u>0</u>	<u>(9,229)</u>
Net cash provided(used) by operating activities	<u>(51,525)</u>	<u>58,260</u>
<u>Cash flows from investing activities</u>		
Loans to officers	(42,807)	(53,200)
Net cash used by investing activities	<u>(42,807)</u>	<u>(53,200)</u>
<u>Cash flows from financing activities</u>		
Net payments on short-term borrowings	<u>(4,337)</u>	<u>(14,670)</u>
Net cash used by financing activities	<u>(4,337)</u>	<u>(14,670)</u>
Net decrease in cash	(98,669)	(9,610)
Cash, beginning	<u>40,105</u>	<u>49,715</u>
Cash, ending	\$ <u>(58,564)</u>	\$ <u>40,105</u>

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the years for interest	\$ 0	\$ 0
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See auditors' report and accompanying notes

BLIMPIE OF CALIFORNIA, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2004 AND 2003

Note A

Organization and Summary of Significant Accounting Policies

Blimpie of California, Inc., a California Corporation, (the Company), markets Blimpie restaurant franchises in California, as an area franchisor. All of the Company's business is dependent upon the economic conditions within the state of California.

Cash and cash equivalents:

For purposes of the statement of cash flows, all unrestricted investment instruments with original maturities of three months or less are deemed cash equivalents. The Company had no cash equivalents at December 31, 2004 and 2003.

Revenue recognition:

The Company reports franchise fees as income when all material services or conditions relating to the sale of a franchise have been substantially performed or satisfied in accordance with the terms of the franchise agreement. The Company reports direct costs related to franchise fees when the income is recognized.

Continuing franchise fee income and license expense are based on a percentage of the gross revenues earned by operating restaurant units as defined in the franchise agreements.

Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Depreciation:

Depreciation of equipment is computed principally on an accelerated method over five years based on the estimated useful lives of the assets.

License agreement:

The license agreement cost is being amortized on a straight-line basis over a 20-year period.

Basis of presentation:

Certain 2003 balances have been reclassified to conform to 2004 presentation.

BLIMPIE OF CALIFORNIA, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2004 AND 2003

Note B
Franchising Operations

License agreement:

The Company has a license agreement with Blimpie International, Inc. ("BII"), for the exclusive right to use the "Blimpie" trademark and technical information (recipes, methods, processes, etc.) in California. Terms of the license agreement provide that the Company is charged an initial franchise fee for each California location licensed and a continuing license fee of 2.5% of the gross revenues of the restaurants in operation. The term of the license agreement is for 99 years beginning July 1984 with renewal options as defined in the license agreement.

The license agreement, originally signed in 1984, was amended on April 30, 1992. The amended license agreement requires the Company to license not less than three Blimpie locations annually for the next 15 years. The obligation is cumulative and the Company will be credited in succeeding years for the number of Blimpie locations licensed in excess of three in any given year. Should the Company not comply with this requirement, the license agreement shall be deemed automatically terminated and cancelled. However, the agreement shall remain as to those Blimpie Restaurants developed or in the process of development with respect to any franchise or subfranchise executed between the Company and any third party as of the date of default.

Significant commitments and obligations:

In accordance with the terms of each franchisee's agreement, the Company is obligated to provide the following supervision assistance and services: layout, training and pre-opening assistance, operations manual, continuing assistance, as specified in the Uniform Franchise Offering Circular, advertising and promotion, supplies, and pricing.

Franchise ownership changes:

For the year ended December 31, 2004, franchise ownership changes are summarized as follows:

Number of franchises in operation as of December 31, 2003	47
Number of franchises opened during the year	3
Number of franchises closed during the year	<u>(5)</u>
Number of franchises in operation at December 31, 2004	<u>45</u>

Note C
Related Party Transactions

Advances to affiliates:

At December 31, 2004 and 2003, advances to affiliates with common ownership for working capital purposes totaled \$210,798 for 2004 and \$210,798 for 2003. Interest earned on advances to affiliates totaled \$12,648 for 2004 and \$12,648 for 2003.

BLIMPIE OF CALIFORNIA, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2004 AND 2003

Note C

Related Party Transactions - Continued

Advances to officers:

As of December 31, 2004 and 2003, the Company was owed \$378,795 and \$335,988, respectively, for advances made to two of the Company's officers. Interest was charged at rates of 6% to 7% per annum. Interest earned on advances to officers totaled \$19,199 for 2004 and \$14,760 for 2003.

Note D

Lines of Credit

The Company has entered into credit agreements with two banks under which it may borrow up to \$100,000 under revolving lines of credit. Current borrowings bear interest from 7.25% to 9.27% per annum. The stockholder has guaranteed borrowings under the lines of credit.

Note E

Due to Advertising Fund

The Company receives a percentage of each franchisee's sales to be placed in an advertising co-operative fund, at the Company's sole discretion as described in the franchise agreements. At December 31, 2004 and 2003, the Company owed \$175,218 and \$340,826, respectively, to the advertising co-operative fund.

Note F

Commitments

During the years ended December 31, 2004 and 2003, the Company incurred rent expense of \$11,507 and \$12,739, respectively.

Note G

Related Party

Effective January 24, 2002, an officer of the Company purchased a majority interest in Blimpie International, Inc.